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In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 525

MATSON NAVIGATION COMPANY,
Petitioner,

vs.

C. R. SMITH (Successor), SECRETARY OF COMMERCE, STATES STEAMSHIP COMPANY and SAN DIEGO UNIFIED PORT DISTRICT.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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C. R. SMITH (Successor), SECRETARY OF COMMERCE, STATES STEAMSHIP COMPANY and SAN DIEGO UNIFIED PORT DISTRICT,

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

Matson Navigation Company, appellant below, petitions for a writ of certiorari to review the judgment of the Court of Appeals for the Ninth Circuit entered in this case May 17, 1968.

OPINIONS BELOW

The *per curiam* opinion of the court of appeals (App. A, *infra*, p. 1) is reported at 394 F.2d 514. The memorandum opinion and order of the district court (App. B, *infra*, p. 3) is reported at 258 F.Supp. 144. The opinion and order of the Secretary of Commerce (App.C, *infra*, p. 28) is reported at Pike & Fischer, Shipping Regulation Reports, 5 SRR 1111.

JURISDICTION

The judgment of the court of appeals was entered May 17, 1968 (App.A, p. 2). Petition for rehearing was denied June 21, 1968 (App.A, p. 2). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

A steamship operator of freight vessels built with the aid of construction-differential subsidy and employed with the aid of operating-differential subsidy, pursuant to Titles V and VI of the Merchant Marine Act, 1936, as amended, in foreign commerce between the United States West Coast and the Far East, applied for permission under Section 805(a) of that Act to operate these vessels in California-Hawaii domestic commerce in the course of their trans-Pacific voyages. The questions are:

1. Whether the Secretary of Commerce may grant permission for the employment of subsidized vessels in domestic commerce, in competition with the operator of an exclusively domestic, unsubsidized service, without making a determination of the amount of subsidy support to be channelled in consequence into the domestic service, or without adopting any formula or accounting method for ascertaining the magnitude of such subsidy support.

2. Whether, in considering an application for permission to use subsidized vessels in domestic commerce in the course of their foreign voyages, the Secretary of Commerce, for purposes of ascertaining the extent to which the transportation of domestic cargo may be supported by subsidy, is required to test the financial results of the domestic service on a basis of fully distributed costs and, to the extent that this accounting basis leaves discretion in the appraisal of cost items, to explain the basis for the results reached. If

the Secretary of Commerce does not apply the test of fully distributed costs, whether he is not required to apply some accounting method and explain the reasons for his selection of it.

3. Whether, consistent with Section 805(a), subsidy benefits diverted to the support of the transportation of domestic cargo can be balanced, and so eliminated from consideration, by "equalizing forces", such as unspecified aid to domestic operators and statutory and contractual restrictions upon subsidized operators; and, particularly, whether such balancing can be conducted when the amount of subsidy support—the counter to be placed on one side of the scales—is undetermined.

4. Whether the important public purposes declared in the Merchant Marine Act, 1936, as amended, do not require this Court to exercise its supervisory powers in order to correct the inconsistent and chaotic administration of Section 805(a) which has obtained in recent years.

STATUTE INVOLVED

The order of the Secretary of Commerce under review was issued pursuant to Section 805(a) of the Merchant Marine Act, 1936, as amended, 49 Stat. 2012, as amended, 46 U.S.C. § 1223(a). The text of Section 805(a) is set forth at Appendix D, *infra*, p. 86.

STATEMENT

A. Section 805(a) and the Steamship Companies Involved in This Case.

Section 805(a) of the Merchant Marine Act, 1936, as amended (the Act), requires any contractor, such as States Steamship Company (States), receiving operating-differential subsidy (ODS), to file an application and to receive written permission from the Secretary of Commerce (the

Secretary) before operating any vessel in domestic commerce. The Secretary is required to permit every person having "any interest" in such application to intervene and be heard. Permission must be denied if the proposed domestic service would result in "unfair competition" to any person operating exclusively in domestic service or would be "prejudicial to the objects and policy" of the Act. The concluding paragraph of Section 805(a) makes it unlawful for a subsidized operator "to divert, directly or indirectly, any moneys, property, or other thing of value, used in foreign-trade operations, for which a subsidy is paid by the United States", into any domestic operation.

States presently receives ODS for the operation of freight vessels between the United States West Coast and the Far East (App.C, p. 28; SC 9, p. 6; STr. 39, 2731).[1] In 1953 States' predecessor in interest, Pacific Transport Lines, Inc. (PTL), received without objection permission, pursuant to Section 805(a), to make 13 eastbound and 13 westbound calls at Hawaii annually in domestic commerce with vessels in its West Coast-Far East service. *Pacific Transport Lines, Inc.-Subsidy Route 29,* 4 F.M.B. 7 (1952). Subsequent to the merger of PTL into States in 1957 and the execution of States' ODS contract, States entered into a construction-differential subsidy (CDS) contract with the United States for the construction of six new Mariner type

1. References in this petition to the record will be designated as follows: (1) the record made before the district court and paginated by the clerk of the district court in his certificate of October 5, 1966, as supplemented, to the court below, "R." followed by the clerk's page number; (2) the transcript of oral testimony within the Department of Commerce, "STr." followed by pages indicated in the Secretary's certification of record, dated January 14, 1966 (R.295-319); and (3) all other documents certified to the district court, "S" followed by the same letter and number designation and appropriate page number (*e.g.* "SD1, p. 1") as used in the Secretary's certification of record (R.295-319).

vessels to replace its older, slower and smaller, World War II-built vessels then engaged in the West Coast-Far East service; and the new vessels were subsequently constructed (STr. 220-23, 228-35).

By letter dated January 30, 1961, States applied, pursuant to Section 805(a), for permission to increase the number of its eastbound and westbound calls with its trans-Pacific, subsidized vessels at Honolulu in domestic commerce from 13 to 26 in each direction annually (SA1). It is only the second 13 voyages in each direction that are in issue here (although Matson maintains that all 26 must be taken into account in appraising subsidy support).

States' application thus contemplated the operation in California-Hawaii domestic trade on 26 voyages annually of six new Mariner vessels, approximately 48% of whose construction cost and approximately 65% of whose operating cost were and are borne by the federal government (STr. 406-07, 2248, 3186-87; SC12, Item 10 Revised, p. 3). Over the 25-year life of each vessel, such subsidy would amount to some $17,000,000 in ODS and $6,000,000 in CDS, a total of $23,000,000 per vessel, or $122,000,000 for the vessels here involved.[2] More precisely, with respect to the 26 voyages, States receives annually $1,255,800 as Government aid in the form of CDS and $3,582,000 in the form of ODS. As a result of its carriage of California-Hawaii cargo, States must, pursuant to Sections 506 and 605(a) of the Act (46 U.S.C. §§ 1156, 1175(a), refund a portion of the

2. States contemplates that its 26 voyages in California-Hawaii-Far East service will require the full time of five of its new Mariners but only approximately 30% of the time of the sixth Mariner. Hence, the total figures above are computed on the basis of 5.3 Mariners which States estimated it would devote annually to this trade.

CDS and suffer a reduction in ODS, but it still receives subsidy, on an annual basis with respect to the 26 voyages (and apart from its other subsidized voyages), of $3,658,800. (SC12, Item 10, Revised, p. 3.) In addition, States and other subsidized operators enjoy substantial tax advantages not available to unsubsidized operators (46 U.S.C. § 1177(h)).

Matson for over 85 years has provided a complete, all-purpose, non-subsidized cargo service operating exclusively between the West Coast and Hawaii. Matson has paid from its own tax paid funds every penny of the cost of its vessels, specially designed to meet the needs of the Hawaii trade, and of its modern container equipment (a field of operation in which Matson has been an acknowledged pioneer). (SC87, SC88; STr. 3979-81, 4008-14, 5516-21, 5491, 6120-21.) Neither CDS nor ODS, nor the special tax advantages above mentioned, are available to the operator of an exclusively domestic service, such as that operated by Matson. Foreign flag vessels are, of course, barred from the domestic trade. At the same time, any non-subsidized United States flag vessel is free to enter the domestic trade without any governmental permission.[3]

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3. Pursuant to the "grandfather rights" proviso of Section 805(a), Matson, having owned all of the stock of The Oceanic Steamship Company for several years prior to the specified year of 1935, was permitted to continue to hold that stock despite the fact that Oceanic is a small subsidized carrier in the West Coast-New Zealand-Australia service. The Secretary's decision adverted to the Matson-Oceanic relationship in the course of determining, in accordance with the precedents, that Matson in its West Coast-Hawaii service was an exclusively domestic operator entitled to the protection of Section 805(a) against "unfair competition" (App. C, pp. 46-51).

It may also be noted that Matson has recently established a separate foreign, *unsubsidized* trans-Pacific service.

B. The Proceedings.

States' application for the additional 13 voyages in each direction annually, as referred to above, was heard before a Hearing Examiner of the Maritime Subsidy Board (Board).[4] Matson, as an intervenor, contended that the crucial question under Section 805(a) is whether the proposed domestic operation of a subsidized operator will be significantly dependent upon subsidy (including the associated tax benefits available only to a subsidized operator). If so, Matson argued, that is the very evil Section 805(a) is intended to prevent. Further, the acid test of the existence and extent of subsidy support is the profitability of the domestic service on a fully distributed cost (sometimes referred to as fully allocated or full absorption cost) basis. Since, as Matson maintained, the evidence, on States' own revenue and cost estimates, established that the domestic revenues would fail to cover the fully distributed cost of providing the domestic service in the range of $1,000,000 annually (App.F, *infra,* p. 94), the substantial degree to which the domestic service would be dependent upon subsidy was manifest. In Matson's view, these facts required

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4. At the time States' application was filed, the power to grant Section 805(a) permission was vested in the Federal Maritime Board; however, such power was transferred by Congress to the Secretary of Commerce by the provisions of Section 202(b) (1) of Reorganization Plan No. 7 of 1961, 75 Stat. 840, and the Secretary was authorized to delegate such power by the provisions of Section 203 thereof. By Department of Commerce Order 117 (Revised), 27 Fed. Reg. 7687 (subsequently superseded by Department Order 117-A, 31 Fed. Reg. 8087, 15331), the Secretary created the Maritime Subsidy Board within the Department of Commerce and delegated his powers under Section 805(a) to the Board, subject to his power to review and set aside all orders of the Board.

denial of the application, although many additional facts supported the same result.[5]

States urged that no Section 805(a) permission was required for it to call at Hawaii with subsidized vessels, because of the requirement in Sections 506 and 605(a) that a portion of its subsidy be refunded and reduced in connection with such calls. Alternatively, States contended that Section 805(a) permission, if required, must be granted as a matter of law in the light of the subsidy refunds and reductions pursuant to Sections 506 and 605(a). Both of these contentions were rejected by the Secretary and were not in issue before the courts below (App. C, pp. 32-33, 52-53; R. 96-97). In addition, States also contended that its domestic service would not be subsidy-supported, because it was shown to be profitable on an incremental cost basis, and that its application should be granted whether or not supported by subsidy.

In the present context, the application of fully distributed cost vis-a-vis incremental cost accounting is readily illustrated. On their way to and from the Far East, States' subsidized vessels are 2400 miles out in the Pacific, within one or two days steaming time of Honolulu. The incremental approach maintains that the domestic cargo, to or from Hawaii, represents an added-on service, and need bear none of the sizable general or fixed vessel and company costs in placing the vessel, including its carriage of domestic cargo,

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5. The domestic service loss is, and must be, made up from the concurrent foreign operations that are a part of the same 26 voyages. But the 26 voyages, foreign and domestic, operate at a loss without subsidy, which, after all refunds and reductions, amounts to the $3,658,000 previously referred to (*supra*, p. 6). It mathematically follows, so Matson has always contended, that the domestic operation is supported by subsidy to the extent, in round figures, of $1,000,000 annually. This support is without regard to the associated tax benefits available to States as a subsidized operator.

2400 miles off the West Coast. The fully distributed cost method, on the other hand, requires an allocation of such general or fixed costs as between domestic and foreign cargo on a gross revenue, revenue ton-mile, or other appropriate basis, calculated to assure that each class of cargo pays its fair share of the transportation. Having in mind that the purpose under Section 805(a) is to determine the extent, if any, by which the cost of transporting the foreign cargo is diverted to the carriage of the domestic cargo, the incremental approach, it will be seen, assumes that such diversion may occur. Matson has always maintained that States, in its own interest for purposes of applying Section 805(a), should disavow the incremental approach. (*E.g.*, SA64, p.5; App. C, pp. 65-66)

The State of Hawaii and Public Counsel, who is an officer of the Maritime Administration employed to protect solely the public interest, participated at all stages of the proceedings before the Examiner, and took no position until all of the evidence was in. Both then supported Matson in opposing States' application, and, among many other considerations, fully endorsed the need for determining the extent of States' subsidy benefits in the domestic trade on the basis of the fully distributed cost of providing the domestic service, or full absorption accounting. (SA52, SA55.)[6]

The Hearing Examiner, with some 30 years experience in Maritime cases, heard every witness and ruled on every exhibit. His recommended decision (SA64) made extensive findings of fact. Among other things, he adopted full absorption accounting as the proper basis for determining the

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6. Public Counsel is not authorized to participate as an advocate after the Board has rendered its decision. The State of Hawaii did not participate in the proceedings before the courts below, except by way of filing a statement of position (R. 723-26), which reaffirmed Hawaii's opposition to the granting of States' additional permission here involved.

degree of subsidy support to States' domestic service and found that such support would amount to approximately $1,000,000 annually. Applying precedents under the Act, he therefore recommended denial of States' application on each of the independent grounds, under Section 805(a), of unfair competition to Matson and prejudice to the objects and policy of the Act.[7]

The Maritime Subsidy Board, reviewing the recommended decision, reversed the Examiner's decision and held for States (SA80). In most important respects, the Board adopted the findings of fact of its Hearing Examiner, including his determination that subsidy support existed, as shown on the basis of fully distributed costs. Nevertheless, the Board fashioned and applied a new test which held that States' application could not be denied unless it was found that subsidy would give States an "overwhelming, unconscionable advantage" over Matson to such a degree that Matson could no longer compete effectively for available cargo (SA80, p. 18). The reasoning of the Board's decision was disavowed, at least in terms, by the decision of the Secretary here under review.[8]

Matson and the State of Hawaii, pursuant to Department of Commerce Order 117 (Rev.), promptly filed petitions requesting then Secretary Hodges to review the order of the

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7. The Hearing Examiner did recommend that States be permitted to increase its calls in San Diego commerce from 13 to 26 and that it be permitted to make such additional calls in California-Hawaii commerce as might be required to lift any cargo which Matson could not carry on two weeks' notice (SA64). Matson did not oppose the portion of States' application relating to San Diego-Hawaii commerce, and, save for the administrative problems created thereby, would not have objected to the two-week provision.

8. The Board's final opinion and order were issued and served on November 27, 1963, some 27 days after the Board's then former Chairman, who purportedly participated in such final opinion and order, had left the Government service to return to private business.

Board. These petitions were granted by the Secretary, and the order of the Board was stayed pending his review. On April 23, 1964, the Secretary issued his opinion and order, denying States' application in the main but authorizing States to carry westbound cargo from California to Hawaii on 13 additional voyages a year on condition that right of first refusal upon two weeks' notice be given to Matson and other unsubsidized operators in the trade (SA94; 1 M.A. 37). The principal basis for Secretary Hodges' decision was that granting States' application would be prejudicial to the objects and policy of the Act because "Government subsidy dollars would be used to support the domestic leg of the service" proposed by States and such service would have more than a *de minimis* adverse effect upon the earnings and financial strength of Matson, the principal unsubsidized domestic carrier already serving the trade (SA94, pp. 7-8; 1 M.A. at 40).

Thereafter, States filed suit against Secretary Hodges in the United States District Court for the District of Columbia. However, prior to any decision by that court on the merits, Secretary Hodges, joined by all the parties, requested the court to remand the case to him for the purpose of vacating his decision and for further consideration (SD5, SD8, SD9). Two other cases applying the same legal test employed by Secretary Hodges in the instant case were not vacated and remain in the books as precedents.[9] Soon thereafter, Secretary Hodges retired and Secretary Connor was brought into Government service.

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9. American Export Lines, Inc.—U.S. Atlantic-Puerto Rico Service, 1 M.A. 285 (1964); Grace Lines, Inc.—Application to Call at Puerto Rico, 1 M.A. 284 (1964). Secretary Hodges' opinion and order in the present case is reported at 1 M.A. 37 (1964).

The case was then re-reviewed by a stranger to the proceeding denominated a Review Examiner, who adopted a line of reasoning also disavowed by the new Secretary in the instant decision. Secretary Connor thereafter, on July 6, 1965, issued the decision now under review (App. C, p. 28), granting States' application for the additional 13 voyages in California-Hawaii domestic service. As had the Board, the Secretary accepted most of the Hearing Examiner's findings of fact, but fashioned a new test of "substantial competitive advantage" for the application of Section 805(a), quite inconsistent with the test employed by Secretary Hodges in the two extant decisions referred to as well as with the great body of administrative precedents.

Matson invoked the jurisdiction of the district court pursuant to 28 U.S.C. §§ 1331, 1337, 2201 and 2202, and 5 U.S.C. §§ 702, 706; and under its general jurisdiction to review orders of federal officials (*Stark v. Wickard*, 321 U.S. 288 (1944); *Pacific Far East Line, Inc. v. FMB*, 275 F.2d 184 (D.C. Cir. 1960), certiorari denied 363 U.S. 827). The district court's memorandum opinion and order (App. B, p. 3), affirming the Secretary's opinion and order of July 6, 1965 was affirmed by the court of appeals' *per curiam decision* (App. A, p. 1). Matson's timely petition for rehearing with suggestion of rehearing *en banc* was denied by the three-judge panel which had heard the case on June 21, 1968 (App. A, p. 2).[10] There has been no stay of the Secretary's order granting permission for the additional 13 voyages (a total of 26 in each direction annually) in domestic commerce.

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10. The Rules of the United States Court of Appeals for the Ninth Circuit, effective prior to July 1, 1968, relating to hearings and rehearings *en banc* (Rule 23, last paragraph), departed significantly from the current Federal Rules of Appellate Procedure (Rule 35).

REASONS FOR GRANTING THE WRIT

Analysis of the Secretary's decision in the light of the terms and legislative history of Section 805(a) and other judicial and administrative decisions establishes, we submit, within the sense of Rule 19, the advisability of granting certiorari to review the decision below. The court below, affirming the district court and thereby the Secretary's decision, has decided an important question of federal law which has not been, but should be, settled by this Court; the decision below conflicts, in principle, with two other decisions of courts of appeals, and conflicts with prior administrative decisions; and in certain aspects it has decided, by affirming the district court and thereby the Secretary's decision, important federal questions in a way in conflict with applicable decisions of this Court.

I

THE SECRETARY'S DECISION, AS AFFIRMED BY THE COURTS BELOW; THE TERMS AND LEGISLATIVE HISTORY OF SECTION 805(a); AND PRIOR ADMINISTRATIVE DECISIONS; THE TWO OTHER COURT OF APPEALS DECISIONS CONSTRUING SECTION 805(a).

A. The Secretary's Decision, as Affirmed by the Courts Below.

The Secretary's decision, although fortified by a tone of reasonableness, minimizes the element of subsidy support (and associated tax advantages) flowing from the foreign service into the domestic service to an extent wholly impermissible in the light of the terms and the legislative history of Section 805(a). The decision acknowledges, as it obviously must, that the carriage of domestic cargo "would be benefited *to some extent* because of subsidy" (App. C, p. 60; emphasis ours). But the decision declines even to estimate the amount of the "some extent". The decision further acknowledges that the Mariner vessels to be used by States are "newer and faster than Matson's, would not have been

built without CDS and would not be operated by States without ODS". Further, the decision recognizes, after subsidy rebates and refunds, the facts are not erased "that these vessels are in existence and are in trans-Pacific service on Trade Route 29 passing by Hawaii *and that subsidy helped build them and put them there*" (App. C, pp. 60-61; emphasis ours).

The decision finds (as Matson agrees) that the proposed domestic operation "would be profitable on an incremental accounting basis", but accepts the conclusion of both the Hearing Examiner and the Maritime Subsidy Board (as Matson also agrees) that the operation "would be unprofitable on a full absorption basis" (App. C, p. 67). The Secretary, nevertheless, refuses either to settle upon an accounting method or to recognize the need for any such approach.[11] Instead the Secretary regrets the absence of "an impartial accounting study" in the record and notes that "[p]articularly with regard to the designation of items as fixed costs of doing business by an enterprise, and as to the proportions in which they are properly allocable to different operations, there are several methods of cost allocations, producing a variety of results." (App. C, pp. 66-67.)

The district court agreed "that the Secretary did not come to any exact dollar figure of residual subsidy benefit", although the court thought it unnecessary for him to do so: "Faced with a number of acceptable accounting methods he was free to choose the figure which he considered most

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11. Before the courts below, Matson, *inter alia*, (1) read the Secretary's decision as approving the fully distributed cost approach and accepting the Hearing Examiner's finding of resulting domestic loss, made good by subsidy, in the range of $1,000,000. In the alternative, Matson contended that (2) if the Secretary failed to settle upon an accounting method and to determine the extent of the loss and consequent subsidy support, the case should be remanded to him to supply missing findings. In view of the evident unwillingness of the courts below to interpret the decision as set forth in (1) above, Matson no longer contends that the decision should be so read.

accurate as long as it was a reasonable figure which accorded with modern accounting practice." (App. B, pp. 21-22.) The court went on to say it would have accepted "any of the figures based on full absorption accounting" (App. B, p. 22). What the Secretary thought the test should be or what figure the Secretary used in balancing subsidy against other factors did not concern the court.

Also, the decision astonishingly refuses to recognize the competitive advantage flowing to States due to the tax deferment granted it under Section 607(h) of the Act, 46 U.S.C. § 1177(h). The Secretary does not dispute, for example, the proposition that States may purchase its vessels with earnings upon which no federal taxes have been paid, whereas Matson, like other unsubsidized operators, must purchase its vessels out of tax-paid funds. The Secretary's only response is: "I do not believe that States' following of procedures sanctioned by law in this regard would amount to unfair competition within the meaning of 805(a)" (App. C, p. 64). Of course, the subsidy payments themselves are "sanctioned by law", and this fact presents rather than answers the problem.[12] The district court did not even mention these substantial tax benefits to States.

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12. Some 15 years ago the immense importance of the tax benefit provisions of the Act was recognized in high quarters:

> "Though given little specific emphasis in the enactment of the 1936 act, the tax provisions of that legislation have yielded benefits estimated at $155 million through the end of 1951. This amount is roughly equivalent to the net operating subsidies granted during the same operating period, despite the fact that such operating subsidies were originally intended to be the principal form of maritime aid." (Letter of President Truman to the Speaker of the House of Representatives, January 16, 1953, transmitting studies prepared by the Department of Commerce and the Treasury Department concerning the American Merchant Marine and Federal Tax Policy and Scope and Effect of Tax Benefits Provided the Maritime Industry.)

Although due to the Korean hostilities the corporate tax rates then reached a maximum level of 70% and are somewhat lower today, the significance of such tax benefits remains self-evident. The Revenue Act of 1936 provided a 15% corporate rate.

The Secretary's refusal to confront the magnitude of the subsidy (and tax benefits) diverted from the support of foreign commerce into the domestic operation vitiates his present decision when measured against (A) the purpose and policy of Section 805(a), and (B) the reasoning and analysis of Section 805(a) set forth in the only two decisions of courts of appeal aside from the present case.

We reluctantly submit that the Court is here confronted with a calculated refusal to decide *the* crucial question in the case—the amount, precise or approximate, of the subsidy support to the domestic trade. The endeavor, instead, was to decide the case on the basis of other circumstances, without first forthrightly confronting the factor which Congress considered the most crucial. If such an approach can be countenanced, a mockery is made of the administrative process and of the wholesome national purpose proclaimed in Section 805(a) of the Act.

B. Section 805(a) and Its Legislative History Condemn the Diversion of Subsidy to Support the Transportation of Domestic Cargo.

The Act provides a comprehensive system of construction and operating subsidy benefits, including tax deferral privileges, for American flag operations in foreign commerce (46 U.S.C. §§ 1151-1183, 1177(h)). Such benefits and privileges are logically not extended to domestic operations, from which foreign-flag vessels are excluded. As the district court correctly noted, however: "Another important purpose of the Act was to promote the maintenance of an unsubsidized, privately owned merchant fleet sufficient to carry the nation's 'domestic waterborne commerce' " (App. B, p. 12). Section 805(a) of the Act was intended primarily to further the latter objective. Subsidy and tax support had their place in the battle against foreign-flag competition;

they had no place in the domestic service as against unsubsidized, American flag operations.

The Act was passed in 1936 against a long background of the misuse of subsidy monies paid to support American flag operations in foreign commerce. These abuses, which included the syphoning of subsidy funds into the domestic trade, were disclosed in two separate investigations; one conducted by Postmaster General Farley and the other by a special Senate Committee under the chairmanship of Senator Black.

According to the Farley Report, "millions of dollars of mail pay has been diverted from use in foreign trade and used to operate in intercoastal and coastwise trade, resulting in *unfair competition* with nonsubsidized American lines in the same trade." (H.R. Doc. No. 118, 74th Cong., 1st Sess. 11 (1935); emphasis ours.) The report emphatically recommended that:

> "All American operators in . . . [domestic trade] should receive the same treatment. Aid in that particular trade should be given to all or none, and any change in policy or law should carry with it the same kind of protection and benefits to all." (*Id.* at 19.)

The Black Committee Report was, if anything, more emphatic in its condemnation of the diversion of subsidy money into the domestic trade:

> "It surely cannot be contended that Congress ever intended mail contracts to be let on links of intercoastal routes, wherein the competition to be faced by the operator was only from other American interests. This was well known to Government officials administering the Merchant Marine Act of 1928, but despite that knowledge such contracts were let and are being operated today. Thus there is placed in the hands of the favored contractor a murderous economic weapon to be *used against his American competitors* in a trade

wherein vessels of foreign registry *may not engage.*" (Investigation of Air Mail and Ocean Mail Contracts. S. REP. No. 898, 74th Cong. 1st Sess. 14 (1935); emphasis in original.)

The Black Committee recommended, among other things, that "no operating subsidy should be paid to a shipping operator whose business or interests are in the protected coastwise or intercoastal" trades, and that "[n]o subsidy should be paid for the benefit of any operator whose financial or corporate structure . . . permits the diversion of the subsidy into activities other than bona fide American-flag foreign-trade shipping enterprises. . . ." (*Id.* at 42-43.)[13]

Senator Black introduced the amendment that eventually became Section 805(a) (79 CONG. REC. 6499 (1935)). The original amendment provided an absolute prohibition against domestic operations by subsidized operators. It prevented not only unfair competition, but any domestic operations whatever by subsidized operators.

The House Committee on Merchant Marine and Fisheries reported a bill (H.R. 8555) during the first session of the 74th Congress, which the minority members condemned as permitting "continuation of the unsound policy of subsidies to inter-coastal operators . . . thus placing subsidized American lines in *unfair competition* with unsubsidized American lines . . ." (H. R. REP. No. 1277, 74th Cong., 1st Sess. 35 (1935), emphasis ours.) Congressman Wearin, in an effort to obviate the minority objections, proposed the

13. It will be noted that the expressions "intercoastal routes", "coastwise or intercoastal" trades, etc. were used in the above passages, as well as express language barring subsidy in trades where "vessels of foreign registry may not engage", and confining subsidy to "foreign" trade. Section 805(a) uses the expression "domestic intercoastal or coastwise service". Of course, Mainland-Hawaii and Mainland-Puerto Rico fall within these references to domestic commerce, from which foreign-flag vessels are excluded.

addition of the Black Amendment to H.R. 8555. His avowed object in amending the bill was to confine subsidized steamship company activities to "the development of the foreign service which is being subsidized" and to protect others "against *unfair competition* from a steamship company who is receiving financial aid and prestige from the Government" (79 CONG. REC. 8581 (1935); emphasis ours).

In the final version of Section 805(a), the absolute prohibition was replaced by the prohibition in Section 805(a) against granting permission to subsidized operations that would result in "unfair competition" to exclusively domestic operators or be "prejudicial to the objects and policy of the Act". It is clear from the portions of the legislative history above referred to that the use of subsidy in any significant degree by one operator in direct competition with a domestic operator was regarded by the framers of the Act as inherently "unfair competition".[14] At the same time, subsidized

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14. Analogy may be found in other statutes where Congress, on the basis of its legislative inquiries, has itself established the connection between two facts or circumstances. For example, it was contended in the early days of the National Labor Relations Act that the Board lacked jurisdiction unless findings could be made in a particular case that (1) continuance of the unfair labor practices involved would in fact lead to (2) strikes and other obstructions to interstate commerce. The Supreme Court dealt with this matter in *NLRB v. Jones & Laughlin*, 301 U.S. 1, 43 (1937), as follows:

> "The fact that there appears to have been no major disturbance in that industry [the steel industry] in the more recent period did not dispose of the possibilities of future and like dangers to interstate commerce which Congress was entitled to foresee and to exercise its protective power to forestall."

And see *Virginian Ry. v. Federation*, 300 U.S. 515, 557 (1937). The contention was more nakedly advanced in *NLRB v. Alloy Cast Steel Co.*, 117 F.2d 302 (6th Cir. 1941), where it was argued that the Board lacked jurisdiction because nothing in the record established that the respondent's (1) "refusal to bargain has at any time" (2) "led or tended to lead to labor disputes burdening or obstructing commerce". (117 F.2d at p. 303). The court rejected this contention, quoting the above passage from the *Jones & Laughlin* case, and concluding that Congress itself, on the basis of long experience, had

operators might be permitted to operate in the domestic trade in situations where there were no exclusively domestic services and no prejudice otherwise to the objects and policy of the Act. While the "prejudicial to the objects and policy" of the Act clause is more general and vague than the "unfair competition" clause, prevention of subsidized intrusion into the domestic trade was quite obviously an important policy of the Act.

To make doubly sure subsidy would not be used in the domestic trade, the concluding paragraph of Section 805(a) makes it unlawful for a subsidized operator "to divert, directly or indirectly, any moneys, property, or other thing of value, used in foreign-trade operations, for which a subsidy is paid by the United States, into any" domestic operation. This provision is obviously of great importance. By its terms, the provision cannot be violated unless the requested permission is granted, but it clearly requires the Secretary to deny any Section 805(a) application when the evidence shows (as it does in this case) that such a diversion will occur if the application is granted. Any other construction would impute to Congress the foolish intent that permission may be granted to do that which it has expressly made unlawful.[15]

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determined that the prohibited conduct had a tendency to cause obstructions of interstate commerce.

So, in Section 805(a), where Congress has established the nexus between (1) subsidy paid to support foreign commerce, resulting in (2) presumptive unfairness and prejudice when spilled over to support domestic commerce.

15. The Secretary's decision in applying its test of "substantial competitive advantage" adverted to Matson's "predominant" position in the West Coast-Hawaii trade (App. C, p. 58), but did not read Section 805(a) or the policy of the Act to authorize the diversion of subsidy into the domestic trade in order to combat the predominance of one carrier, or generally to promote competition. We think it true that nothing in the Act authorizes the diversion of subsidy funds from foreign commerce into the domestic trades

Consistent with the clear language of Section 805(a), a long line of decisions has meticulously protected the domestic operator against subsidized competition, holding such to be *prima facie* unfair competiton and prejudicial to the objects and policy of the Act. See, *e.g.*, *American President Lines—Unsubsidized Operation, Route 17*, 3 F.M.B.—M.A. 457, 470 (1951); *American President Lines, Ltd.—Section 805 (a) Application*, 4 F.M.B.—M.A. 436, 440 (1954); *American President Lines, Ltd.—Subsidy, Route 17*, 4 F.M.B.—M.A. 488, 504 (1954); *T. J. McCarthy Steamship Co.—Sec. 805(a) Application*, 5 F.M.B. 666 (1959); *Waterman S.S. Corp.—Sec. 805(a) Application*, 6 F.M.B. 115 (1960); *American Export Lines, Inc.—U.S. Atlantic-Puerto Rico Service*, 1 M.A. 285 (Sec'y Commerce 1964); *Grace Line, Inc.—Application to Call at Puerto Rico*, 1 M.A. 284 (Sec'y Commerce 1964).

The present Maritime Subsidy Board declared in its first Section 805(a) decision:

> "Section 101 of the Act states as a prime object 'that the United States shall have a merchant marine suffi-

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in order to enforce any policy of the antitrust laws. That is the business of the Department of Justice and, to the more limited extent that antitrust policies are to be observed, of the Federal Maritime Commission, which enforces the Shipping Act, 1916, as amended, 46 U.S.C. §§ 801 *et seq.*, and the Intercoastal Shipping Act, 1933, as amended, 46 U.S.C. §§ 843 *et seq.*

Prior to August, 1964, Matson was in large part owned by four important Hawaii agricultural, factoring and shipper interests. By the terms of a consent decree entered by the United States District Court for the District of Hawaii on August 17, 1964, three of these four interests were required to sell their stock in Matson, and the fourth interest, Alexander & Baldwin, Inc., was placed under severe restraints in the routing of its cargo and otherwise. The terms of the consent decree are set forth in Appendix E, *infra*, p. 88. We include this decree in order to make the point that the Act is not concerned with the enforcement of the antitrust laws, and that any problems in this area have been taken in charge by the Department of Justice. (SD 16, pp. 57-60, 127-29; SD 20.)

> cient to carry its domestic water-borne commerce.' This unmistakably charges us with responsibility for protecting and preserving domestic water carriers. We are not unmindful of the generally unfortunate plight in which the United States domestic fleet finds itself." *States Steamship Co.—Additional Calls at Hawaii,* 1 M.A. 131, 135 (1961).

The Hearing Examiner reflected the force of these decisions in his own Recommended Decision in the instant case when he correctly stated:

> "Basically, the Act elevates a subsidized operator to a most favored financial position, one that is not shared by domestic operators, who must sink or swim on their own abilities." (1 M.A. at 64.)

Particularly relevant in this regard is *Pacific Far East Line, Inc. — Section 805(a) Applications,* 4 F.M.B. 580 (1955). In that case the applicant sought to provide general agency services for a domestic operator, and the only evidence of record respecting subsidy diversion reflected that the estimated fees to be paid for the general agency services would be sufficient to cover the "added cost" of providing such services. Applicant failed to show what the total cost of providing such services would be. In this state of the record, the Board held that the applicant had failed to establish the absence of subsidy diversion into the proposed domestic operation, stating as follows:

> "Performance of the proposed general agency by PFEL on an added cost basis, however, would result in an advantage to Coastwise. Whether this advantage amounts to unfair competition, however, cannot be determined from this record. * * * We cannot, therefore, make the statutory finding that the proposed agreement will not result in unfair competition." (4 F.M.B. at 591.)

The Secretary's decision in the instant case, as affirmed by the courts below, cannot be squared with the terms of Section 805(a) or its purpose and policy as revealed by the foregoing legislative history, and as affirmed in the administrative decisions above cited.[16]

C. Other Section 805(a) Cases in the Courts of Appeals.

Apart from the instant case, there have been only two cases in the courts of appeal construing Section 805(a). The reasoning and analysis of both cases, although not their decisions, conflict with the Secretary's decision in the present case and its affirmance by the courts below.

In *Seatrain Lines v. Hodges,* 320 F.2d 737, 740 (D.C. Cir. 1963), the court referred to the anti-diversion paragraph of Section 805(a) as follows:

> "The obvious purpose is to preclude having any part of the subsidy aid the domestic operations, for which no subsidy is available, and to prevent an advantage for one carrier to the detriment of his domestic competitors."

In *Pacific Far East Line, Inc. v. FMB,* 275 F. 2d 184, 186 (D.C. Cir. 1960), certiorari denied, 363 U.S. 827, the same court stated:

> "The Department of Justice, on behalf of the United States, urges that competition is not 'unfair' within the meaning of the Act when it does not involve diversion of money to unsubsidized domestic operations from subsidized foreign operations, to the disadvantage of an unsubsidized operator. Congress plainly did intend to prevent that sort of competition".

That case (unlike the present case) involved a proposed exclusively domestic service to be conducted by a subsidized

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16. Other administrative decisions, which have unhappily departed from the clear meaning and purpose of Section 805(a), are referred to under IV, *infra,* pp. 30-31.

operator but with *unsubsidized* vessels. On the evidence, the court held that the Board had not shown that the proposed domestic service would be "unfair". The court remanded the case to the Board for further findings on the question of prejudice to the objects and policy of the Act.[17]

In this case, the court further gave as an example of unfair competition, "fixing rates below cost and using the profits of its subsidized Far East trade to carry the loss" (275 F.2d 184, 186). The last-quoted language strikingly fits the present case, although the Secretary's decision failed so to apply it. During most of the years of record Matson's earnings provided far less than a fair return on its investment and, beginning in September, 1959, Matson was forced to take cognizance of rising costs by effecting rate increases. By August, 1964, due in large measure to the success of its container program, Matson completed a cutback process restoring its rates in general to the August, 1961, level. During the five years from September, 1959, to August, 1964, States called at Hawaii 13 times annually in each direction; its labor costs were the same as Matson's; and, even on an incremental basis, its earnings from the domestic trade, like Matson's, were inadequate. Yet States consistently during these five years maintained its domestic rates at levels below Matson's, the disparity during one period amounting to 35%. (STr. 6220-25, 7573-74; SD16, pp. 136-40.) Plainly, States was able to maintain such rates only because of subsidy. Indeed, even today, in view of the domestic loss on the 26 voyages, States would have to increase its West Coast-Hawaii rates merely to break even. We have, therefore, in the instant case the example

17. Pacific Far East Line thereafter withdrew its application to serve Hawaii, and the Board therefore made no further decision in the case (SA64, p. 2, fn. 4).

to which the court of appeals referred in the *Pacific Far East Line* case: "fixing rates below cost and using the profits of its subsidized Far East service to carry the loss. . . ."

The decision of the court of appeals herein, affirming the district court and leaving in effect the Secretary's decision, conflicts in principle with the reasoning and analysis of Section 805(a) in the *Pacific Far East Line* and *Seatrain* cases, *supra;* and decides an important question of federal law, concerning the administration of Section 805(a), which has not been, but should be, settled by this Court. No less than in the recent case of the "debit agents", certiorari should be granted, to paraphrase the language of the Court, in view of the "importance of the question in the context involved to the administration" of the Merchant Marine Act, 1936, as amended. *NLRB v. United Ins. Co.*, 19 L.Ed.2d 1083, 1086 (1968).

II.

THE NECESSITY OF APPLYING FULLY DISTRIBUTED COSTS.

The law seems to be clear that when the true cost of carrying on some one portion of an overall enterprise must be determined, a fully distributed cost basis — that is, a fair method of allocating *all* costs — is the only method sanctioned. Here the "portion" referred to is the transportation of domestic cargo on the 26 trans-Pacific voyages, and the "over-all enterprise" is the 26 mixed voyages between the West Coast and the Far East via Hawaii, which engage in the transportation of both domestic and foreign cargo.

This Court held that the method of fully distributed costs was essential to decision in *Northern Pacific Ry. Co. v. North Dakota,* 236 U.S. 585, 596-97 (1915):

"[W]e entertain no doubt that, in determining the cost of the transportation of a particular commodity, all the outlays which pertain to it must be considered. We find no basis for distinguishing in this respect between so-called 'out-of-pocket costs,' or 'actual' expenses, and other outlays which are none the less actually made because they are applicable to all traffic, instead of being exclusively incurred in the traffic in question. Illustrations are found in outlays for maintenance of way and structures, general expenses and taxes. It is not a sufficient reason for excluding such, or other, expenses to say that they would still have been incurred had the particular commodity not been transported. That commodity has been transported; the common carrier is under a duty to carry, and the expenses of its business at a particular time are attributable to what it does carry. The State cannot estimate the cost of carrying coal by throwing the expense incident to the maintenance of the roadbed, and the general expenses, upon the carriage of wheat; or the cost of carrying wheat by throwing the burden of the upkeep of the property upon coal and other commodities. This, of course, does not mean that all commodities are to be treated as carried at the same rate of expense. The outlays that exclusively pertain to a given class of traffic must be assigned to that class, and the other expenses must be fairly apportioned. It may be difficult to make such an apportionment, but when conclusions are based on cost the entire cost must be taken into account."

To the same effect holding mandatory the application of fully distributed cost accounting are, for example, *Government of Guam v. FMC*, 329 F.2d 251 (D.C. Cir. 1964) and *Alaska Steamship Co. v. FMC*, 344 F.2d 810 (9th Cir. 1965). Indeed, the predecessor of the present Maritime Subsidy Board held it necessary to probe beyond incremental accounting in *Pacific Far East Line, Inc.—Section* 805(a)

Applications, 4 F.M.B. 580 (1955), which has been quoted in part, *supra* p. 22.

As we have seen, Section 805(a) requires that the profitability of the domestic operation be determined, in a mixed voyage situation such as is here involved, in order to gauge the dimension of subsidy support. This in turn, requires the test of fully distributed costs, or, if not, some other test (unknown to us) to be explained and justified by the administrative agency or official who administers Section 805(a). Section 805(a) does not present a case where the administrative agency is given broad discretion "as to the proper balance to be struck between conflicting interests," Congress itself having made that determination (See *NLRB v. Brown,* 380 U.S. 278, 292 (1965); also *American Ship Building Co. v. NLRB,* 380 U.S. 300 (1965). Accordingly, the Secretary has decided an important question of federal law, involving the application of Section 805(a), in a way in conflict with applicable decisions of this Court.

We do not suggest, of course, that incremental accounting does not have its place in the business or even the legal world. Sometimes a railroad may be permitted or even required to carry some commodities at less than their fully distributed costs of transportation. See *Baltimore & Ohio R. Co. v. United States,* 345 U.S. 146 (1953). Such cases do not touch the point here involved. The question is what test does the substantive law require. The *Baltimore & Ohio* case did not deny that the test of fully distributed costs was the measure of whether the rates there involved were below full cost.

The recent case of *American Lines v. Louisville & N.R. Co.,* 20 L.Ed. 2d 1289 (1968), wherein the action of the Interstate Commerce Commission in its application of fully distributed costs was affirmed, involved a statute, which, read in the light of its legislative history, apparently left the

Commission with a considerable area of discretion as to the accounting test to be considered. Section 805(a), read in the light of its legislative history, seems to circumscribe the discretion of the administrative agency much more strictly. The *American Lines* case is of significance in the present context both because of the test which the Commission there applied, and because of this Court's discussion of the important and perhaps never-ending conflict between fully distributed costs and incremental or "marginal" costs.

III.

THE SECRETARY'S PURPORTED BALANCING EXERCISE.

The Secretary's decision endeavors to balance subsidy support of the domestic operation against "equalizing forces" and perhaps other considerations (App. C, pp. 67-68). Assuming for present purposes that such a balancing exercise is permissible, the difficulty at this point is that the Secretary has never determined *what* he is balancing against such equalizing or other forces (pp. 14-15, *supra*). Exactly as in the recent case of *United States v. Third National Bank*, 390 U.S. 171 (1968), a remand is in order so that the balancing operation can be properly performed. As the Court there concluded (pp. 183-84):

> "To weigh adequately one of these factors against the other requires a proper conclusion as to each. Having decided that the court below erred in assessing competitive impact, we should remand, so that the District Court can perform again the balancing process mandated by the Act." (Footnote appended to quotation omitted.)[18]

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18. The district court in the present case seems to have accepted, although in a backhand manner and without discussion, the need for full absorption accounting. Further, the district court seems to have assumed at one point a consequent loss in the domestic operation of some $1,200,000 annually. (App. B. pp. 22-23.) If we are correctly reading the district court's opinion, the diffi-

IV.

THE CHAOTIC ADMINISTRATION OF SECTION 805(a).

Following the decision of the Court of Appeals for the District of Columbia Circuit in *Pacific Far East Line, Inc. v. FMB, supra,* in 1960, the Board (as well as Matson) unsuccessfully petitioned for certiorari. No. 907, October Term, 1959, 363 U.S.827. The Board's petition maintained that, in reversing and remanding on the issue of unfairness, the court of appeals had brought into question numerous prior Board decisions; that the issues involved were of "wide importance" (petition, p. 9); and that (pp. 15-16):

> "Moreover, relaxation of the standards of Section 805(a) may be expected to encourage many additional subsidized operators to seek to invade the domestic trades. Thus, the decision of the Court of Appeals is likely to have a disruptive effect upon all of the domestic trades and to discourage the lines currently dedicated to these trades from attempting to continue in them. This would be detrimental both to the national defense and to the maintenance of stable and dependable common carrier water services to the areas involved."

The intervening years would seem to have justified the concern of the Board as expressed in 1960. Apart from the present case, attempted invasions of the domestic trades by American Export Lines and Grace Line with their subsidized vessels are reflected in the decisions of Secretary Hodges heretofore cited (*supra,* pp. 11, 21). Attempts by

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culty remains that the Secretary of Commerce made no such findings or assumptions. The balancing operation, if it is permissible, is to be performed by the administrative agency or official, and not by the reviewing court, as is clear from the teaching of *Burlington Truck Lines v. United States,* 371 U.S. 156, 168-69, and the decisions therein cited.

subsidized lines or their affiliates to employ non-subsidized vessels in domestic commerce are reflected in *American Export Isbrandtsen Lines, Inc., Section 805(a) Application*, Pike & Fischer, Shipping Regulation Reports, 9 SRR 997 (1968) (the *AEIL* case) and in the pending MSB Docket No. S-191, *American President Lines, Ltd.—Application to Serve Hawaii.*[19]

Further, the years since 1960 have produced their jungle of erratic and contradictory decisions at the various administrative levels. The instant case, with its five disparate decisions through the Secretary's decision here under review, provides a not atypical example. In the *AEIL* case, in which review by the Secretary was denied, the Maritime Subsidy Board has recently departed quite plainly from the very decision of Secretary Connor in the instant case, as well as from other prior decisions, and has relaxed to virtually the point of extinction the safeguards intended by Section 805(a). The Board among other matters suggested, contrary to the decision herein and to other decisions, that as a matter of law the profits of a subsidized shipping line may be used by a parent holding company in domestic commerce (9 SRR at 1002-03); that, once the issue of unfair competition has been determined adversely to a statutory intervenor under Section 805(a), he is not entitled to a hearing on the second issue of prejudice to the objects and policy of the Act (9 SRR at 1004); that the agency and operating relationship of a subsidized line in furnishing services to vessels operating in domestic commerce, including the question of whether such services are

19. It may be noted that Seatrain Lines, Inc. has recently announced its plans to enter the West Coast-Hawaii trade, and one of its officers outlined its plans as a witness in Docket No. S-191. Seatrain falls outside Section 805(a); as an unsubsidized carrier, it is free to enter the Hawaii domestic trade at any time, without any governmental permission or franchise.

in fact fully compensated, are matters to be handled *ex parte,* on which statutory intervenors are likewise not entitled to be heard (9 SRR at 999, 1003); and that the adequacy of the service presently provided by unsubsidized operators in a domestic trade, and the financial impact of the proposed service upon such operators, are immaterial to the granting of Section 805(a) permission (9 SRR at 1004).[20] We do not suggest, to be sure, that the Court review the *AEIL* case in this proceeding; we do believe it of relevance in deciding whether certiorari should be granted.

We have not in this petition discussed numerous matters which will likely be the subject of briefing in the event certiorari is granted. These would include the adequacy of the service in the West Coast-Hawaii trade, past, present and prospective; the financial impact of subsidized competition on Matson and other unsubsidized operators, and the chilling effect which subsidized competition has upon the entry of prospective, unsubsidized operators into the trade; the fact that the permission given States is unlimited as to the tonnage it may carry in the domestic trade on the 26 voyages referred to; the evidence that States intends to reserve some 40% of its vessel space on westbound voyages for domestic cargo (App. C, p. 80); and the circumstances leading to the Secretary's provision for a three-year review proceeding (App. C, pp. 84-85), which review, however, assumes the validity of his decision.

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20. The Board cast aside, virtually without mention, the Examiner's decision in the case (9 SRR 161). The case was an unusual one, but the Board itself regarded its declarations of the law to be applied as having "precedential effect" (9 SRR at p. 1001).

Also, we have not in this petition detailed the evidence supporting Matson's determination of a loss in the domestic operations, as sustained by the Hearing Examiner and as adverted to by the Secretary and the district court, in the range of $905,458 to $1,280,416 annually (which we have referred to in this petition as a loss in the order of $1,000,000). In this connection, at Appendix F, p. 94, we have included a table, with supporting references, which was included in our brief to the courts below. Further, if certiorari is granted, Matson will desire to argue that its evidence on the question of domestic losses is *prima facie* correct, and, on remand, is to be accepted unless the Secretary can point out specific deficiencies, or selects, with justification, some accounting method other than that of fully distributed costs.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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September, 1968.